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SUBJECT: BRAZIL: 2003 GDP GROWTH EVEN WORSE THAN EXPECTED

REFS: (A) Brasilia 450, (B) 03 Brasilia 3682

1. (U) The GoB has revised its 2003 growth number downward from its already twice-downscaled estimate of positive 0.3%, to negative 0.2%, Brazil's worst since 1992. In addition to being half a percentage point below its own most recent forecast, the growth figure was below those of even the most pessimistic market analysts, whose last predictions were in the range of -0.1% to +0.3.

2. (U) Parsing the numbers on the supply side: the 5% growth in agriculture (9% of the economy) was insufficient to offset declines of -1% in industry (about 38% of the economy) and -0.1% in the services sector. On the demand side, private consumption was down 3.3% and government consumption up a modest 0.6%, while investment fell 6.6% -- particularly concerning, given the need for infrastructure investment to reduce Brazil's economic bottlenecks, notably in transportation. The only unalloyed positive was exports, up over 14% on the year, helped by the competitive effects of the Real's devaluation in 2002.

Brazilian GDP
Percent Growth - Seasonally Adjusted

	Annual/1		2003 Quarterly Growth/2			
	2002	2003	1Q03	2Q03	3Q03	4Q03
Total GDP	1.9	-0.2	-0.8	-0.9	0.1	1.5
Supply Side						
- Agriculture	5.5	5.0	3.9	0.2	-6.4	7.3
- Industry	2.6	-1.0	-2.1	-3.5	2.6	1.2
- Services	1.6	-0.1	-0.7	-0.1	0.2	0.8
Demand Side						
- Consumption						
(Private)	-0.4	-3.3	-1.5	-1.3	0.4	1.6
Govt.	1.4	0.6	0.6	0.2	-0.1	0.1
- Investment	-4.2	-6.6	-4.6	-6.8	2.3	4.0
- Exports	7.9	14.2	-1.7	4.4	1.2	5.5
- Imports	-12.3	-1.9	3.4	-2.1	0.4	8.3

/1 Percent Change on Previous Year

/2 Percent Change on Previous Quarter

Source: Statistics and Geographic Institute (IBGE)

3. (U) The GoB economic team, busily spinning the results, is pointing out the silver lining: that growth rebounded to 1.5% in the fourth quarter of 2003. Agriculture as usual led the way on the supply side, with blazing 7.3% growth, followed by industry (1.2%) and services (0.8%). Exports and investment led fourth-quarter demand-side growth. Exports grew 5.5%, and investment, encouragingly, grew for the second straight quarter (2.3% and 4%, respectively). Private consumption, the major component of demand, also rose for the second straight quarter, by 1.6%, after growing 0.4% in the third quarter. In extensive interviews over the weekend, Planning Minister Mantega and Treasury Secretary Levy maintained that these figures show the economy bottomed out sometime in the third quarter of 2003 and has been growing at a healthy clip since. Lula has been quoted endorsing the same theme. Even IMF Managing Director Horst Kohler, briefly visiting Brazil, got into the act, stating his belief that the Brazilian economy is on a "firm foundation" for substantial growth this year.

4. (U) The GoB's argument is logical, but we have our doubts. Multiple recent data points suggest the trajectory of economic growth in 2004 may prove far flatter than the 1.5% growth of the fourth quarter of 2003 (slightly over 6% when annualized). National unemployment has begun to climb again, to or towards new records, to 11.7% in January up from 10.9% in December (also up from 11.2% in January 2003).

Per capita GDP was down 1.5% in 2003; this feeds through to average monthly incomes, down 6.2% in the twelve months ending in January 2004. The Central Bank, after reducing its benchmark SELIC interest rate by 10 percentage points in the second half of 2003, has halted the decline in interest rates at 16.5%. Given market expectations of 5.6% inflation over the next twelve months, this means a real interest rate of 10.9%, and commercial-bank spreads on lending to private entities remain far above even these double-digit levels.

15. (U) The trajectory of investment, up 2.3% in the third quarter of 2003 and a further 4% in the fourth quarter, is certainly promising. But will it be sustained in 2004? The national development bank (BNDES) reports that approvals for new financing were down 16%, and applications for financing down over 40%, year-on-year, in January; and according to the Central Bank total credit actually dipped from 25.4% to 25.1% of GDP between December 2003 and January.

16. (SBU) Admittedly, growth at even half the rate of the last quarter of 2003 would achieve the low end of the GoB's 3-3.5% target for 2004. A further question is the sustainability of even such moderate growth into the longer term. By general consensus, this will depend on the GoB's timely achievement of a raft of proposed 'microeconomic' reforms to reduce the rigidities of the Brazilian economy and further overhaul public finances. Expectations for 2004 in this line were always limited, and there is now also the prospect that the current corruption scandals will weaken Lula's legislative hand or distract the Congress from economic reform (Septel). In sum, the advent of a solid GDP upturn still seems based more on hope than on facts.

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